

July 23, 2004

Ms. Jennifer J. Johnson, Secretary
Board of Governors of the Federal Reserve System
20th and C Streets, N.W.
Washington, DC 20551

Re: Comments to Proposed Amendments To Regulation J -- Docket No.: R-1202

Dear Ms. Johnson:

The undersigned financial services industry organizations and technology companies (the “Commenters”) respectfully submit their comments regarding the Federal Reserve Board’s proposal (the “Proposal”) to amend Regulation J. The attached document reflects the collective efforts of the undersigned Commenters.

If you have any questions regarding our comments, please contact any of the representatives of the undersigned Commenters.

Sincerely,

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| America’s Community Bankers | American Bankers Association |
| Bank of America, N.A. | Bank One |
| BITS | Citibank |
| Consumer Bankers Association | Deutsche Bank Trust Company Americas |
| EDS | Electronic Check Clearing House Organization (ECCHO) |
| The Huntington National Bank | Independent Community Bankers of America |
| KeyBank | NACHA -- The Electronic Payments Association |
| National Association of Federal Credit Unions | PNC Bank |
| The Clearing House Association L.L.C | The Financial Services Roundtable |
| US Bank | Wachovia Corporation |
| Wells Fargo & Company | |

Comments to Regulation J

1. General Comment - Relation of Regulation J to Regulation CC and Check 21 Act. The Proposal includes a number of provisions that describe or restate the liability of a sender, a Federal Reserve Bank or a paying bank under the Check 21 Act and subpart D of Regulation CC. In light of these provisions, and the fact that the Federal Reserve Board has regulatory authority under the Check 21 Act, there may be confusion as to whether Regulation J establishes a different standard of liability than would otherwise arise under the Check 21 Act. Accordingly, we recommend that the final rule include a provision in Section 210.3 (General Provision) of the final regulation that states that nothing in Regulation J alters the liability or obligations of any party that is otherwise established under the Check 21 Act or subpart D of Regulation CC.

Suggested Regulatory Text:

Section 210.3(f): "...Nothing in Regulation J shall alter, reduce or expand the liabilities or obligations of parties interested in a substitute check as established by the Check Clearing for the 21st Century Act and subpart D of Regulation CC."

2. General Comment - Use Of The Term "Handle." In numerous places, Regulation J and the Proposal refer to a Reserve Bank "handling" an item, which may include handling a substitute check or an electronic representation of a substitute check. We recommend that the Supplementary Information accompanying the final rule clarify that the term "handling" as used in Regulation J, when referring to the handling of a substitute check or representation of a substitute check, would constitute a transfer, presentment or return of a substitute check and receipt of consideration as those phrases are used under Section 229.52 of subpart D of Regulation CC and Section 5 of the Check 21 Act. This interpretation of the term "handle" in the Supplementary Information accompanying the final rule would make it clear that when a Federal Reserve Bank handles a substitute check as contemplated under Regulation J, the Reserve Bank is making the warranties under the Check 21 Act and subpart D of Regulation CC to persons that subsequently receive the substitute check.

Suggested Text for Supplementary Information to Final Rule:

"When a Reserve Bank handles a substitute check, or a paper or electronic representation of a substitute check, the Reserve Bank is transferring that check and receiving consideration for that check for purposes of making the warranties under Section 5 of the Check 21 Act and Section 229.52 of subpart D of Regulation CC to subsequent parties that receive that check."

3. Warranties Regarding MICR Line. Section 210.5(a)(4)(i) of the Proposal includes a new warranty from the sender to the Reserve Bank. The sender warrants that the electronic item, that is not a representation of a substitute check, “replicates the MICR line of the original check, except for any changes required or permitted by part 229, subpart D of this chapter for substitute checks....” We have three comments on this new warranty.

A. Replication of MICR Line: We believe that it may not be accurate to state that “the item...replicates the MICR line of the original check.” Rather, in a standard image file exchange, the image has an electronic file associated with that image which contains an electronic record of information from the MICR line on the check. The MICR line itself is not “replicated” for purposes of processing the electronic item. While the image of the check includes the image of the MICR line, that image of the MICR line is not used for processing the image of the check. Rather, the MICR line information contained in the associated electronic file is used by collecting and paying banks to process the image, including processing that may result in the subsequent printing of a substitute check. We recommend that this Section be revised to clarify that the item includes a record of the MICR line information. (See suggested regulatory text below next comment.)

B. MICR Line at Time of Truncation: We recommend that the warranty under Section 210.5(a)(4)(i) state that the item must contain the MICR line of the original check at the time of truncation, and not the MICR line at the time the original check was issued. We commented extensively on this MICR line issue in our May 18, 2004 comment letter to the Regulation CC proposal, and incorporate those comments here.

In addition to the above recommended change to this Section of the Proposal, we recommend conforming changes be made to Sections 205.6(b)(3)(i)(A), 205.12(c)(4)(i) and 205.12(e)(1)(iii)(A)(1) which contain similar regulatory text.

Suggested Regulatory Text To Address Comments 3(A) and 3(B)

Section 210.5(a)(4)(i): “The item accurately represents all of the information on the front and back of the original check as of the time that the original check was truncated; includes a record of the MICR line of the original check at the time of truncation, except for any changes required or permitted by part 229, subpart D of this chapter for substitute checks ...” [*new text underlined*]

C. Position 44 and Recognition of Industry Standards. We recommend that the discussion of Section 210.5(a)(4)(i) in the Supplementary Information to the final rule clarify that the phrase “except for any changes required or permitted by part 229, subpart D of this chapter for substitute checks” does not require the sending bank to code position 44 of the MICR line of an electronic item in the manner required for substitute checks or electronic representations of substitute checks. Images of original checks should not contain the Position 44 code that identifies a substitute check or an image of a substitute

check. As a related matter, we also recommend that the discussion of this Section in the Supplementary Information to the final rule state that the reference to changes permitted or required under Regulation CC for substitute checks would include changes required or permitted by the generally applicable industry standards for substitute checks.

Suggested Text for Supplementary Information to Final Rule to Address Comment 3(C)

“The warranty under Section 210.5(a)(4)(i) permits a sender to make permissible or required changes as set forth under the generally applicable industry standards for substitute checks, which are recognized under Section _____ of Regulation CC. However, a sender shall not code position 44 of the MICR line in accordance with the generally applicable industry standards for substitute checks when handling an electronic item that is not a representation of a substitute check.”

4. Sender Indemnity.

In Section 210.5(a)(5)(iv) of the Proposal, the sender indemnifies the Reserve Bank for any indemnity made by the Reserve Bank under Section 229.53 of Regulation CC if the sender sent a substitute check or a paper or electronic representation of a substitute check. We recommend that this section include an express statement that the indemnity only applies if the Reserve Bank delivered a substitute check to a receiving bank and as a result the Reserve Bank was required to make the indemnity under Section 229.53 of Regulation CC. This change would make it clear that the delivery of a substitute check, as a required pre-condition for the indemnity under Section 229.53 of Regulation CC, must be satisfied for the indemnity under Regulation J to apply.

Suggested Regulatory Text:

Section 210.5(a)(5)(iv): “Any indemnity made by the Reserve Bank under § 229.53 of this chapter to a recipient of a substitute check, as described in § 210.6(b)(2)(ii) of this subpart...” [*new text underlined*]

5. Limitation on Reserve Bank Liability.

A. Recognition of Liability Arising Under Check 21 Act. As discussed above, a Reserve Bank, as a “bank” under the Check 21 Act, may incur liability under the Check 21 Act with respect to a substitute check or an electronic representation of a substitute check. However, the limitation on Reserve Bank liability in Section 210.6(c) does not reference the Check 21 Act as a source of potential Reserve Bank liability, and therefore could be interpreted to exclude liability of a Reserve Bank arising under the Check 21 Act, to the extent that such liability is different than liability arising under Regulation J. Accordingly, we recommend that Section 210.6(c) expressly recognize that a Reserve

Bank may incur liability arising under the Check 21 Act. As a related matter, Section 210.12(e)(2) of the Proposal addressing liability in the return process recognizes a Reserve Bank's liability arising under subpart D of Regulation CC, but not liability arising under the Check 21 Act. The proposed text below sets forth recommended revisions to both of these Sections of the Proposal to address this issue.

Suggested Regulatory Text:

Section 210.6(c): "A Reserve Bank shall not have or assume any liability to the paying bank or other payor, except as provided in paragraph (b) of this section, as provided for under the Check Clearing for the 21st Century Act or in part 229, subpart D of this chapter, or for the Reserve Bank's own lack of good faith or failure to exercise ordinary care." [*new text underlined*]

Section 210.12(e)(2): "A Reserve Bank shall not have or assume any other liability to any person with respect to a returned check except-

- (i) As provided in paragraph (e)(1) of this section;
- (ii) For the Reserve Bank's own lack of good faith or failure to exercise ordinary care as provided in subpart C of part 229 of this chapter; or
- (iii) As provided under the Check Clearing for the 21st Century Act or in part 229, subpart D of this chapter." [*new text underlined*]

B. Reserve Bank Participation in Expedited Recredit Procedure for Banks. The Check 21 Act and subpart D of Regulation CC provide that a Reserve Bank is a "bank" and therefore is subject to the expedited recredit procedure under Section 229.55 of subpart D of Regulation CC and Section 8 of the Check 21 Act. However, the limitation on liability set forth in Section 210.6(c) of the Proposal could be read to inappropriately exclude Reserve Banks from the application of the expedited recredit procedure. Accordingly, we request that the discussion of Section 210.6(c) in the Supplementary Information accompanying the final rule clarify that nothing in that Section exempts a Reserve Bank from the expedited recredit procedure for banks.

Suggested Text for Supplementary Information to Final Rule:

"The limitations on liability in Section 210.6(c) do not limit the obligation of a Reserve Bank as a bank under the expedited recredit procedure set forth in Section 8 of the Check 21 Act and Section 229.55 of subpart D of Regulation CC."

6. Time for Commencing Actions Against Reserve Banks.

We have two comments to Section 210.6(d) relating to the time period for commencing an action against a Reserve Bank.

First, with respect to Section 210.6(d)(2), we recommend that the text discussing this section in the Supplementary Information to the final rule clarify that the standard for accrual of a claim under that Section should be interpreted consistently with the standard for the accrual of claims under Section 229.56(c) of Regulation CC. This Section 210.6(d)(2) is intended to establish the time period for commencing a claim under Section 210.6(b)(3), which contains an indemnity from the Reserve Bank for an electronic item that is subsequently turned into a substitute check. Since the time limit in Section 229.56(c) of Regulation CC will apply to claims that are brought by a paying bank's customer with respect to such a substitute check, the paying bank should have the same time period for bringing a claim under the Section 210.6(b)(3) indemnity against a Reserve Bank that provided the related electronic image.

Suggested Text for Supplementary Information to Final Rule:

“The time period for commencing an action against a Reserve Bank under Section 210.6(d)(2) should be interpreted consistently with the standard for the accrual of actions under Section 229.56(c) of subpart D of Regulation CC.”

Second, with respect to Section 210.6(d)(3) of the Proposal, the text of the Proposal states that the time period for commencing an action “does not lengthen” the time limits for claims under 229.38(g) or under subpart D of Regulations CC. We recommend that the phrase “does not lengthen” be replaced with the phrase “does not alter.” We believe that this new phrase is more appropriate because Section 210.6(d)(3) otherwise could be read as shortening the time period for commencing an action under the referenced Sections.

Suggested Regulatory Text:

Section 210.6(d)(3): “This paragraph (d) does not alter the time limit for claims under section 229.38(g) (which include claims for breach of warranty under § 229.34 of this chapter) or part 229, subpart D of this chapter.” [*new text underlined*]

7. Application of Indemnities in Section 210.5(a)(5)(iv) and (v).

Sections 210.5(a)(5)(iv) and (v) of the Proposal set forth two new indemnities from the sending bank to the Reserve Bank. Both of these indemnities allow the Reserve Bank to seek an indemnity from the sending bank when the Reserve Bank is itself liable for an indemnity under Regulation J and subpart D of Regulation CC. We believe that these sending bank indemnities in the Proposal are overbroad in that they would appear to allow a Reserve Bank to recover from a sending bank regardless of whether the electronic

image or substitute check provided by the sending bank to the Reserve Bank was the cause of the liability of the Reserve Bank under its indemnities under Section 229.53 of Regulation CC and 210.6(b)(3)(ii) of Regulation J.

For example, a sending bank may provide the Reserve Bank with a good image of an original check, and the Reserve Bank inadvertently alters or ruins that image and prints a substitute check with a bad image. As another example, after the sending bank sends a check image to the Reserve Bank, multiple substitute checks from that one image are created by the Reserve Bank and presented to the paying bank. In both these examples, the Reserve Bank should be responsible under the Check 21 Act warranties, without recourse to the sending bank. Accordingly, we recommend that these sending bank indemnities be revised in the final rule to make it clear that the sending bank's breach of its warranty relating to the electronic item must be the cause of the liability arising to the Reserve Bank in order for the Reserve Bank to recover against the sending bank under the indemnities.

Suggested Regulatory Text:

Section 210.5(a)(5)(iv): Any indemnity made by the Reserve Bank under § 229.53 of this chapter, as described in § 210.6(b)(2)(ii) of this subpart, if the sender sent a substitute check or a paper or electronic representation of a substitute check to the Reserve Bank to the extent that the Reserve Bank's liability arose from the sender's breach of the warranty under Sections 210.5(a)(3)(ii) or 210.5(a)(4); and

Section 210.5(a)(5)(v): Any indemnity made *[by]* the Reserve Bank under § 210.6(b)(3)(ii) of this subpart to the extent that the Reserve Bank's liability arose from the sender's breach of the warranty under Section 210.5(a)(4), if the sender sent an electronic item that was not a representation of a substitute check to the Reserve Bank. *[new text underlined]*

8. Scope of Warranty and Liabilities Under Section 210.6(b)(3)(i) and (ii).

Section 210.6(b)(3)(i) of the Proposal provides that the Reserve Bank makes certain warranties regarding the item to "the bank to which it transfers or presents the item." Similarly, the indemnity from the Reserve Bank in Section 210.6(b)(3)(ii) is made only to "the bank to which it transfers or presents the item." By comparison, under Section 210.6(b)(1) the Reserve Bank makes certain warranties to the "subsequent collecting bank and the paying bank and any other payor." We believe that the warranties in Section 210.6(b)(3)(i) and indemnity in Section 210.6(b)(3)(ii) should apply to the same parties as listed in Section 210.6(b)(1), and the text of these sections should be conformed accordingly.

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